

FOREIGN SERVICE EDUCATIONAL FOUNDATION

1906 FLORIDA AVENUE, N. W.

WASHINGTON 9, D. C.

December 1, 1959

Dear Allen:

Sunday night I may have put the case somewhat over dramatically. Obviously we, and the free world coalition, can conceivably survive a suspension of gold payments by the U.S. It would be a tremendous shock, however.

What I had in mind I expanded on at somewhat greater length in a memorandum I sent Doug Dillon last week. I enclose a copy.

As ever,

Paul

Enclosure:

Paul H. Nitze

The Honorable Allen W. Dulles
Director, Central Intelligence Agency
2430 E Street, N.W.
Washington 25, D.C.

Paul H. Nitze
November 24, 1959

MEMORANDUM ON U.S. BALANCE OF PAYMENTS

This has been a topic I have been concerned with for some time. In February of this year I submitted to the Draper Committee a draft of a study on the objectives of our aid programs in relation to the purposes of our foreign policy. I included a few pages emphasizing the changed U.S. balance of payments situation within which I then thought our aid programs should be viewed. Today the situation seems even more serious than it did then.

Discussion of this problem, at least among those outside the Government, has seemed to me not to have dealt with the full panoply of pertinent factors. In the following pages an attempt is made to organize these factors under three headings (a) Analysis of the facts (b) Clarification of objectives (c) Courses of action. The substance of the individual factors is not dealt with in any rigorous manner. The purpose of this memorandum is merely to suggest a more comprehensive method -- an approach which relates facts and objectives to possible courses of action with concern for magnitudes and for time.

Analysis of Facts

A vast amount of statistical and other information relating to the U.S. balance of payments is available. The problem seems to be not so much one of availability of facts as one of identifying those that are relevant.

- 2 -

What standards of relevance come to mind? I take it that two facts worry us. The first is that we have become the repository of a substantial portion of the free world's monetary reserves and must concern ourselves with the responsibilities and disadvantages of such a position. The second is the increase in our adverse balance from a level of approximately $1\frac{1}{2}$ billion per year in the years 1950 to 56 to 3.4 billion and 4 billion in 1958-59. The relevant questions seem to be the following: How much of this shift is due to temporary, accidental, non-recurring causes? How much of it is due to more continuing causes? Which of these more continuing causes are subject to automatic self-correction and of what magnitude, over what time period? Which of them appear to indicate trends which are not automatically self-correcting over any short time period?

I haven't made a detailed study, but I would suspect that the accidental factors tend to cancel each other out -- some have been against us, some with us. I would further suspect that the automatically self-correcting factors will prove to be substantially balanced by important factors in which the trend is against us. If this is so, there is a serious basic problem before us.

How much time have we within which we have to accomplish what results?

- 3 -

I suspect that, if we are still running an adverse balance of 4 billions two years from now, the inherent instability of our foreign exchange position -- resulting in part from our having become a respository for other countries' reserves, monetary and other -- will cause, or will already have caused, a movement toward more secure liquidity on the part of holders of dollar claims, halted at some point by a moratorium on further gold sales by us.

If, however, the adverse balance has by then been reduced to a billion or so, such a movement toward liquidity would be unlikely even though the ratio of our gold holdings to foreign short term dollar claims would be continuing to worsen. The rate of change would be in the right direction. It would have been demonstrated that we had the will and capability sensibly to control our affairs.

The risks seem to me to be two fold. On the one hand the Administration may decide that in the last year of its term of office, and in an election year, no really substantive policies can be initiated. On the other hand those changes in policy which are adopted can be dominated by purely short range fiscal considerations rather than by the full range of objectives and requirements of our national strategy.

In such a situation the role of the State Department, and particularly of the Under Secretary of State, is crucially impor-

- 4 -

tant. In the past the Secretary of State, in his capacity as the leading member of the Cabinet concerned with our national strategy, has been the principal advisor to the President on those matters where foreign policy and domestic policy become intertwined. In economic and financial matters, the Under Secretary has had to carry much of this burden for him. If the Treasury Department dominates this field many of the broader objectives of policy tend to become submerged under purely fiscal considerations.

How then might the Under Secretary address himself to the current balance of payments problem?

Clarification of Objectives

A first contribution can be a clarification of objectives and their interrelations. I take it we would like to see an accelerated growth rate internally not subject to sudden checks by balance of payments crises. We should like to see a continuing expansion of the free world's foreign trade under conditions of minimum artificial restrictions. We should like to increase the military security of the free world while reducing our reliance upon threats of general atomic war. We should like to further develop the assistance of the Western industrialized countries to the underdeveloped ones. We should like to defend all this against disruption by Soviet initiatives. We should like to increase the

- 3 -

political and economic integration of the free world. The sum total of such objectives and of the courses of action best designed to give them concurrent support constitutes the essence of our national strategy. The State Department is the only agency of the Executive Branch, short of the President, concerned with all aspects of this strategy. The refinement and interrelation of the various aspects of this strategy gives point and direction to national policy and is the legitimate source of the Secretary and Under Secretary's influence with other parts of the Government on these matters.

Courses of Action

There are certain reasonably obvious and non-controversial measures the Under Secretary can support both because they are good in themselves and because they will buy some time in which more incisive measures can be analyzed, developed into action programs and support for them secured.

The obvious and reasonably non-controversial measures are already underway. They include the effort to end, or at least mitigate, foreign discrimination against our exports, the effort to get the now foreign-exchange-rich industrial countries to carry a further share of the foreign aid, investment and defense burden, exhortation to our exporters to do a better job, and the decision

- 6 -

that those seeking aid from the United States should seek only that aid which can be supplied most efficiently from the United States in real terms.

I do not believe these measures alone give any high probability or assurance of adequate results within the time period available. If the Under Secretary shares this concern I should think he might explore the following additional measures.

1. Schemes to make the International Monetary Fund the principal repository of central bank reserves. This was originally proposed by Keynes. In recent months Robert Triffin has interested himself in the idea. I see great advantages in the scheme in a number of directions. I doubt whether there is any other scheme which will buy us adequate time to make the other revisions in policy necessary for a long run solution of our problem.

2. Changes in our overseas military deployments and methods which will reduce dollar costs while increasing military effectiveness. Our initial overseas military arrangements were designed to minimize the economic drain on others and thus maximized the dollar drain on the U.S. A number of ways of reversing these policies come to mind.

- 7 -

3. A greatly expanded program to stimulate exports. Today industry is more interested in getting a foot in the Common Market, etc., by acquiring subsidiaries abroad than in increasing exports. More than exhortation is going to be needed. The Business Advisory Council to the Secretary of Commerce could be organized into subcommittees to make a real thing of an export drive. Concurrently the reorientation of the Department of Commerce staff to the promotion of exports could be gotten underway. The Export Import Bank could be directed to get going on a general program of export credit guarantees.

4. Reduction of the high cost and inefficiency of many of our domestic arrangements. This is the heart of the matter but politically the most ticklish field. I believe it must eventually be tackled. Analysis and education should be gotten underway now. We cannot indefinitely support a farm policy which raises internal costs, involves high budgetary expenses, cuts down on exports and appears to be of marginal benefit to the farmers. The theory that any agreement arrived at by collective bargaining is in the public interest needs reexamination. If our high cost levels are undermining our competitive position in crucial sectors, the community as a whole has a vital interest in the reversal of such trends. Our tax structure, in the encouragement that it gives to excessively expensive practices, and the slight incentive it

- 8 -

gives to cost reduction, deserves reexamination. It may be necessary to expand the tax base as suggested by Congressman Mills.

As a final point it may be useful to return to the question of the analysis of the facts.

During the development of the Marshall Plan, the State Department pulled together a team of some thousand people, largely from other agencies, to make as rigorous as possible a projection of the production, fiscal, and foreign trade and payments patterns of all the affected countries on a series of alternative hypotheses as to United States policy. The resulting projections were, as it turned out, wrong as to a number of the details. But these errors in detail largely cancelled out, and the resulting overall estimates were almost exactly fulfilled when the plan was put into operation. Today's problems may be more difficult to project accurately. I believe, however, that a serious effort would today yield highly useful insights.

As a preliminary to such a study, it might be useful to recruit a small group of consultants to the Under Secretary to share in an examination of the problem as a whole. I should think the group should be informal and with no publicity given to its selection. Among names which come to mind are Lincoln Gordon, Robert Triffin, Arthur Burns, Gerhard Colm, Jim Nicely, Fred Eaton.